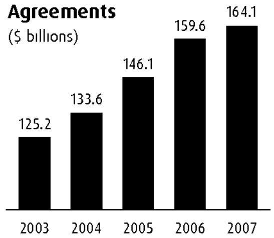
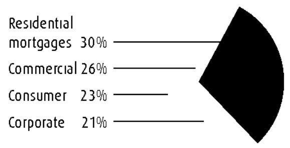
**Net Loans – Excluding Securities Borrowed or Purchased under Resale Agreements**
($ billions)




Loan growth slowed due to the conversion of mortgages to mortgage-backed securities and the weaker U.S. dollar.

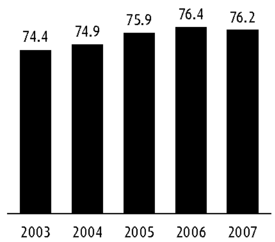
**Portfolio Diversification – Gross Loans and Acceptances***




*Excluding securities borrowed or purchased under resale agreements

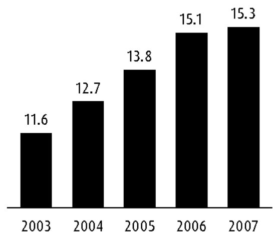
The portfolio remains well diversified, with a lower level of residential mortgages.

**Deposits from Individuals**
($ billions)




Deposits from individuals remain stable despite a weaker U.S. dollar.

**Shareholders' Equity**
($ billions)




Shareholders' equity increased despite reduced earnings and increased dividends.

## Net Loans and Acceptances ($ millions)

| As at October 31 | **2007** | 2006 | 2005 | 2004 | 2003 |
|---|---|---|---|---|---|
| Residential mortgages | **52,429** | 63,321 | 60,871 | 56,444 | 52,095 |
| Consumer instalment and other personal loans | **33,189** | 30,418 | 27,929 | 24,887 | 22,103 |
| Credit cards | **4,493** | 3,631 | 4,648 | 3,702 | 2,967 |
| Businesses and governments | **62,650** | 56,030 | 47,803 | 44,559 | 44,167 |
| Acceptances | **12,389** | 7,223 | 5,934 | 5,355 | 5,611 |
| Securities borrowed or purchased under resale agreements | **37,093** | 31,429 | 28,280 | 22,609 | 20,998 |
| Gross loans and acceptances | **202,243** | 192,052 | 175,465 | 157,556 | 147,941 |
| Allowance for credit losses | **(1,055)** | (1,058) | (1,128) | (1,308) | (1,785) |
| Net loans and acceptances | **201,188** | 190,994 | 174,337 | 156,248 | 146,156 |

Net loans and acceptances increased $10.2 billion to $201.2 billion. Residential mortgages decreased $10.9 billion, reflecting the conversion of BMO-underwritten Canadian mortgages to government-insured mortgage-backed securities. The decrease also reflects a reduction in third-party mortgages as a result of the strategy to exit the lower-margin broker sales channel and concentrate on branch-initiated offerings. Credit cards and consumer instalment and other personal loans increased $3.6 billion in total, reflecting healthy personal lending markets. The consumer portfolio remains well diversified, with healthy growth in both Canada and the United States. Loans to businesses and governments and related acceptances increased $11.8 billion due to stronger demand and our strategy of expanding our commercial and corporate banking portfolios. Securities borrowed or purchased under resale agreements increased $5.7 billion as a result of customer demand and our balance sheet management activities. These instruments are very short-term loans that are managed in conjunction with similarly short-term securities lent or sold under repurchase agreements and securities sold but not yet purchased. The weaker U.S. dollar reduced loan growth by $10.8 billion.

Table 11 on page 84 provides a comparative summary of loans by geographic location and product. Table 13 on page 85 provides a comparative summary of net loans in Canada by province and industry. Loan quality is discussed on pages 39 and 67 and further details on loans are provided in Notes 4, 5 and 7 to the financial statements, starting on page 101.

## Other Assets

Other assets increased $2.2 billion to $44.2 billion, primarily due to derivative financial instrument assets. There was a corresponding increase in derivative financial instrument liabilities. There was a decline in the fair value of commodities derivatives offset by an increase in foreign exchange derivatives and equity derivatives.

## Deposits ($ millions)

| As at October 31 | **2007** | 2006 | 2005 | 2004 | 2003 |
|---|---|---|---|---|---|
| Banks | **34,100** | 26,632 | 25,473 | 20,654 | 24,755 |
| Businesses and governments | **121,748** | 100,848 | 92,437 | 79,614 | 72,405 |
| Individuals | **76,202** | 76,368 | 75,883 | 74,922 | 74,391 |
| | **232,050** | 203,848 | 193,793 | 175,190 | 171,551 |

Deposits increased $28.2 billion to $232.0 billion. Deposits from businesses and governments, which account for 52% of total deposits, increased $20.9 billion and deposits from individuals, which account for 33% of total deposits, decreased $0.2 billion. Deposits by banks, which account for 15% of total deposits, increased $7.5 billion. The increase was used to fund loan and trading securities growth. The weaker U.S. dollar reduced deposit growth by $18.1 billion. Further details on the composition of deposits are provided in Note 15 on page 116 of the financial statements and in the Liquidity and Funding Risk section on page 71.

## Other Liabilities

Other liabilities increased $17.6 billion to $114.3 billion. Securities sold but not yet purchased increased $9.6 billion in support of increased trading activity, acceptances increased $5.2 billion, derivative-related liabilities increased $2.1 billion, and there was a $1.3 billion increase in other liabilities. Securities lent or sold under repurchase agreements decreased $0.6 billion. Further details on the composition of other liabilities are provided in Note 16 on page 117 of the financial statements.

## Subordinated Debt

Subordinated debt increased $0.7 billion to $3.4 billion. There were two new issues and one redemption in 2007, as detailed in Note 18 on page 118 of the financial statements.

## Shareholders' Equity

Shareholders' equity increased $0.2 billion to $15.3 billion. The increase was largely related to higher share capital and retained earnings, partially offset by an increase in accumulated other comprehensive loss as a result of the income tax charge levied on gains on hedging our net investment in foreign operations. BMO's Consolidated Statement of Changes in Shareholders' Equity on page 94 provides a summary of items that increase or reduce shareholders' equity, while Note 21 on page 121 of the financial statements provides details on the components of and changes in share capital. Details of our enterprise-wide capital management practices and strategies can be found on page 57.

# Enterprise-Wide Capital Management

## Capital Management Framework

Our capital management framework is designed to maintain an optimum level of capital in a cost-effective structure that: meets our target regulatory capital ratios; meets our internal assessment of required capital; is consistent with our targeted credit ratings; underpins our operating groups' business strategies; and builds long-term shareholder value. Our approach includes establishing limits, goals and performance measures for the management of balance sheet positions, risk levels and minimum capital amounts, as well as issuing and redeeming capital instruments to obtain the most cost-effective capital structure possible. The key elements of our capital management framework are approved by the Board of Directors pursuant to its annual review of our capital management corporate policy and capital plan. Actual capital adequacy is monitored against the capital plan throughout the year and the plan is updated accordingly.

For performance management and decision-making purposes, we allocate capital to lines of business based primarily on the assessment and measurement of the line's economic capital requirements, as outlined on page 66, and regulatory capital requirements. By allocating capital to operating units and measuring their performance with respect to the capital necessary to support the risks in their business, we maximize our risk-adjusted return to shareholders. We also ensure that we maintain a well-capitalized position to protect our stakeholders from the risks inherent in our various businesses, while still allowing the flexibility to deploy resources in the high-return, strategic growth activities of our operating groups. Capital in excess of what we determine is necessary to support our line of business activities is held in Corporate Services.

Our disciplined approach to capital management helps in delivering on our long-standing commitment to enhancing shareholder value.

## Regulatory Capital Review

Capital adequacy for Canadian banks is measured pursuant to guidelines issued by the Office of the Superintendent of Financial Institutions Canada (OSFI), based on standards established by the Bank for International Settlements.

Tier 1 capital represents more permanent forms of capital, and primarily includes common shareholders' equity, preferred shares and innovative hybrid instruments less a deduction for goodwill and excess intangible assets. Tier 1 capital increased $0.4 billion during the year to $17.0 billion. The increase was primarily attributable to growth in retained earnings, the impact of net capital issuances and the reclassification of preferred shares of a subsidiary from Tier 2 to Tier 1 capital. These factors were partially offset by foreign exchange adjustments due to the strengthening of the Canadian dollar.

Total capital includes Tier 1 and Tier 2 capital, net of certain deductions. Tier 2 capital is primarily comprised of subordinated debentures and the eligible portion of the general allowance for credit losses. Tier 2 capital increased during the year primarily due to the issuance of subordinated debentures. Table 20 on page 88 provides additional details on the components of BMO's capital.

Risk-weighted assets are determined by applying OSFI-prescribed rules to on- and off-balance sheet exposures and to market risk exposures related to our trading activities. Risk-weighted assets increased $15.9 billion to $178.7 billion, due primarily to loan and market risk risk-weighted asset growth in BMO Capital Markets. Market risk risk-weighted assets increased in part due to the adoption of a more conservative translation of certain of our trading and underwriting positions to risk-weighted assets for regulatory capital purposes. Personal and Commercial Banking risk-weighted assets were reduced by the execution of initiatives to manage regulatory capital requirements on a cost-effective basis. In 2008, we anticipate continued growth in risk-weighted assets and deployment of capital to strategically advantaged businesses. Table 21 on page 88 provides a detailed breakdown of risk-weighted assets.

The Tier 1 Capital Ratio, Total Capital Ratio and Assets-to-Capital Multiple are the primary capital measures monitored by OSFI.

The **Tier 1 Capital Ratio** is defined as Tier 1 capital divided by risk-weighted assets.

The **Total Capital Ratio** is defined as total capital divided by risk-weighted assets.

The **Assets-to-Capital Multiple** is calculated by dividing total assets, including specified off-balance sheet items net of other specified deductions, by total capital.

The Tier 1 Capital Ratio is our key measure of capital adequacy. It decreased to 9.51% from 10.22% a year ago due to strong risk-weighted asset growth, partially offset by growth in Tier 1 capital. The ratio remains strong and was well above our policy in 2007 of maintaining a ratio of at least 8.0%. In 2008, our target is to maintain a Tier 1 Capital Ratio of at least 8.0%.

Our Total Capital Ratio decreased to 11.74% from 11.76% a year ago. The decrease in the ratio was driven by growth in risk-weighted assets partially offset by a net issuance of subordinated debt and higher Tier 1 capital. Both our Tier 1 and Total Capital Ratios remain well above OSFI's stated minimum capital ratios of 7% and 10%, respectively, for a well-capitalized financial institution.

As noted in the Provisions for Income Taxes section, BMO hedges the foreign exchange risk arising from our net investment in our U.S. operations by funding the net investment in U.S. dollars. This strategy reduces the impact on BMO's capital ratios of changes in foreign exchange rates, as the effect of foreign currency adjustments to Tier 1 capital arising from an increase or decrease in the value of the Canadian dollar is largely offset by the change in the Canadian dollar equivalent of U.S. risk-weighted assets.

BMO's assets-to-capital multiple increased to 17.2 from 16.1 in 2006, due primarily to growth in loans and securities. The multiple remains well below the maximum permitted by OSFI.

## Capital Management Activities

As part of ongoing efforts to manage capital on a cost-effective basis, BMO undertook a number of issuances and redemptions during 2007. We issued $350 million of Class B Preferred shares, Series 13 and $250 million of Series 14. We also issued $1.2 billion of Series D Medium-Term Notes, Second Tranche. We issued $800 million of BMO Trust Subordinated Notes – Series A by BMO Subordinated Notes Trust, a closed-end trust wholly owned by BMO. These Notes are fully and unconditionally guaranteed by BMO on a subordinated basis and qualify as subordinated debt for regulatory purposes. We also redeemed our $150 million Series 22 7.92% Debentures and our $200 million Class B Preferred shares, Series 4, while our US$300 million 7.80% Notes matured. Further details are provided in Notes 18 and 21 to the financial statements.

On August 31, 2007, we announced a new normal course issuer bid, commencing September 6, 2007 and ending September 5, 2008, under which we may repurchase for cancellation up to 25 million BMO common shares, representing approximately 5% of our public float. Under our previous 12-month normal course issuer bid, which expired on September 5, 2007 and allowed for the repurchase for cancellation of up to 15 million common shares, 8,087,400 shares were repurchased at a total cost of $555.6 million. We increased the size of the share repurchase program in 2007 to provide greater flexibility in the management of BMO's capital levels.

Our share repurchase program is primarily used to offset, over time, the impact of dilution caused by issuing shares through the exercise of stock options, our dividend reinvestment plan and exchangeable shares. In 2007, BMO repurchased a total of 7,622,000 shares under our common share repurchase program at a cost of $524.3 million, which exceeded the 5,458,000 shares that were issued during 2007 due to the exercise of stock options, our dividend reinvestment plan and exchangeable shares.

## Dividends

BMO's target dividend payout range is 45%–55% of net income available to common shareholders, the highest among Canada's major banks. The target is reflective of our confidence in our continued ability to grow earnings and our strong capital position. Dividends are generally increased in line with long-term trends in earnings per share growth, while sufficient earnings are retained to support anticipated business growth, fund strategic investments and provide continued support for depositors.

Dividends per common share declared in 2007 totalled $2.71, up 20% from $2.26 in 2006. The dividends declared in 2007 represent 47% of net income available to common shareholders, excluding the impact of significant items, which is within our target dividend payout range of 45%–55%. Dividends declared increased in three of four quarters in 2007, rising 13% from $0.62 per share in the fourth quarter of 2006 to $0.70 per share in the fourth quarter of 2007. At year-end, BMO's common shares provided a 4.4% annual dividend yield based on the closing share price. On November 27, 2007, BMO's Board of Directors declared a quarterly dividend on common shares of $0.70 per share, unchanged from the prior quarter.

For the purposes of the *Income Tax Act* (Canada) and any similar provincial and territorial legislation, BMO designates all dividends paid on both its common and preferred shares in the 2006 calendar year, and all dividends (including deemed dividends) paid thereafter, as "eligible dividends" unless BMO indicates otherwise.

## Credit Rating

During the second quarter of 2007, our credit rating as measured by Moody's Investors Service senior debt ratings was upgraded from Aa3 to Aa1, due to a change in its methodology. During the third quarter, Standard & Poor's Ratings Services lowered its ratings for BMO and its related subsidiaries, including the senior debt rating, to A+ from AA–, citing concerns over our market risk governance and other factors. BMO's senior debt ratings as measured by Dominion Bond Rating Service and Fitch Ratings were AA and AA–, respectively. All four ratings had a stable outlook as of the end of the fiscal year and are indicative of high-grade, high-quality issues.

## Basel II

As described on page 66 in the Enterprise-Wide Risk Management section, we continue to work towards meeting all of the applicable requirements of the Basel II framework, including reviewing our process for assessing overall capital adequacy in relation to our risk profile. This assessment will be subject to review by our regulator, OSFI.

## Tier 1 Capital ($ millions)

| | **2007** | 2006 |
|---|---|---|
| Beginning of year | **16,641** | 15,430 |
| Net income | **2,131** | 2,663 |
| Dividends | **(1,396)** | (1,163) |
| Goodwill and excess intangible assets | **(42)** | (7) |
| Issuance of common shares | **246** | 258 |
| Repurchase of common shares | **(524)** | (376) |
| Other issues net of redemptions | **400** | – |
| Reclassification of preferred shares of subsidiary from Tier 2 capital | **230** | – |
| Translation and other | **(692)** | (164) |
| End of year | **16,994** | 16,641 |

## Risk-Weighted Assets ($ millions)

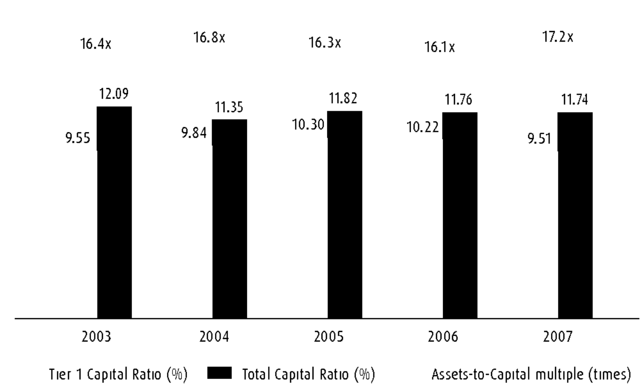
| | **2007** | 2006 |
|---|---|---|
| Beginning of year | **162,794** | 149,855 |
| Increases (decreases) | | |
| Personal and Commercial Banking | **(4,138)** | 4,705 |
| Private Client Group | **680** | (184) |
| BMO Capital Markets | **19,505** | 10,163 |
| Corporate Services | **(154)** | (1,745) |
| End of year | **178,687** | 162,794 |

## Outstanding Shares and Securities Convertible into Common Shares

| As of November 27, 2007 | Number of shares or dollar amount | Dividends declared per share **2007** | 2006 | 2005 |
|---|---|---|---|---|
| **Common shares** | 498,592,000 | **$ 2.71** | $ 2.26 | $ 1.85 |
| **Class B Preferred shares** | | | | |
| Series 5 | $ 200,000,000 | **$ 1.33** | $ 1.33 | $ 1.33 |
| Series 13 | $ 350,000,000 | **$ 0.96** | – | – |
| Series 14 (1) | $ 250,000,000 | **–** | – | – |
| **Convertible into common shares:** | | | | |
| **Class B Preferred shares** (2) | | | | |
| Series 4 (3) | – | **$ 0.91** | $ 1.20 | $ 1.20 |
| Series 6 | $ 250,000,000 | **$ 1.19** | $ 1.19 | $ 1.19 |
| Series 10 | US$ 300,000,000 | **US$ 1.49** | US$ 1.49 | US$ 1.49 |
| **Stock options** | | | | |
| – vested | 15,556,000 | | | |
| – nonvested | 5,071,000 | | | |

(1) Initial dividend declared in November 2007.
(2) Convertible preferred shares may be exchanged for common shares in future years on a pro-rata basis based on 95% of the average trading price of common shares for 20 days ending four days prior to the exchange date.
(3) Redeemed in August 2007.
Note 21 on page 121 of the financial statements includes details on share capital.

**Capital Measures**



## Off-Balance Sheet Arrangements

BMO enters into a number of off-balance sheet arrangements in the normal course of operations. The discussion that follows addresses the more significant types of off-balance sheet arrangements.

### Credit Instruments

In order to meet the financial needs of our clients, we use a variety of off-balance sheet credit instruments. These include guarantees and standby letters of credit, which represent our obligation to make payments to third parties on behalf of a customer if the customer is unable to make the required payments or meet other contractual requirements. We also engage in securities lending where we lend either our securities or our customers' securities to third parties. This exposes us to credit risk, as a third party may not return the securities as agreed. We also write documentary and commercial letters of credit, which represent our agreement to honour drafts presented by a third party upon completion of specified activities. Commitments to extend credit are off-balance sheet arrangements that represent our commitment to customers to grant them credit in the form of loans or other financings for specific amounts and maturities, subject to meeting certain conditions.

There are a large number of credit instruments outstanding at any time. Our customers are broadly diversified and we do not anticipate events or conditions that would lead a significant number of our customers to fail to perform in accordance with the terms of the contracts. We use our credit adjudication process in deciding whether to enter into these arrangements, just as we do when extending credit in the form of a loan. We monitor off-balance sheet instruments to ensure that there are no undue concentrations in any geographic region or industry.

The maximum amount payable by BMO in relation to these credit instruments was approximately $110 billion at October 31, 2007 ($110 billion at October 31, 2006). However, this amount is not representative of our likely credit exposure or liquidity requirements for these instruments as it does not take into account any amounts that could possibly be recovered under recourse or collateralization provisions. In addition, a large majority of these commitments expire without being drawn upon. Further information on these instruments can be found in Note 5 on page 103 of the financial statements.

Securities lending commitments are generally short-term in nature and subject to recall on a demand basis. For all other credit commitments outlined above, in the absence of an event that triggers a default, early termination by BMO may result in breach of contract.

### Derivatives

On November 1, 2006, we adopted the CICA's new accounting requirements for hedging derivatives. The new rules require us to record all of our hedging derivatives in our Consolidated Balance Sheet at fair value (see Note 9, Change in Accounting Policy on page 108). Prior to November 1, 2006, we accounted for derivatives that qualified as accounting hedges on an accrual basis, and our interest rate hedging derivatives represented off-balance sheet items. The fair value of our hedging derivatives was $77 million of assets and $127 million of liabilities as at October 31, 2006. Under the new rules, these hedging derivatives are now recorded at fair value in our Consolidated Balance Sheet.

### Variable Interest Entities (VIEs)

#### Customer Securitization Vehicles

Customer securitization vehicles (referred to as bank-sponsored multi-seller conduits) assist our customers with the securitization of their assets to provide them with alternate sources of funding. These vehicles provide clients with access to financing in the commercial paper markets by allowing them to sell their assets into these vehicles, which then issue commercial paper to investors to fund the purchases. In almost all cases, the sellers continue to service the transferred assets and are first to absorb any losses on the assets. We earn fees for providing services related to the securitizations, including liquidity, distribution and financial arrangement fees for supporting the ongoing operations of the vehicles. These fees totalled approximately $80 million in 2007 and $99 million in 2006.

In general, investors in the commercial paper have recourse only to the assets of the related VIE. Our exposure to losses relates to our investment in commercial paper issued by the vehicles, derivative contracts we have entered into with the vehicles and the liquidity support we provide through standby letters of credit and commitments to extend credit. We use our credit adjudication process in deciding whether to enter into these agreements just as we do when extending credit in the form of a loan. During the year we changed the nature of liquidity lines offered to certain of our Canadian customer securitization vehicles to global style liquidity lines, which have objective criteria for determining when they can be drawn upon. Previously, we offered market disruption liquidity lines, which had more subjective criteria. The total contractual amount of the Canadian support was $20,756 million at October 31, 2007 ($20,237 million in 2006). The total contractual amount of the U.S. support was $10,719 million at October 31, 2007 ($12,366 million in 2006). Included in the U.S. support in 2006 was $634 million related to a credit facility that has been terminated. None of these facilities were drawn upon at year-end.

As at October 31, 2007, BMO held $5,564 million of commercial paper issued by these vehicles ($448 million at October 31, 2006).

BMO sometimes enters into derivatives contracts with these vehicles to enable them to manage their exposures to interest rate and foreign exchange rate fluctuations. The fair value of such contracts at October 31, 2007 was $20 million, which was recorded as a derivative liability in our Consolidated Balance Sheet (derivative liability of $5 million at October 31, 2006).

The level of our ownership of ABCP in two of the vehicles causes us to be exposed to the majority of any expected gains or losses and, as such, the vehicles have been consolidated. Included in our Consolidated Balance Sheet at October 31, 2007 were assets of $311 million classified as other assets and commercial paper of $65 million classified as a deposit liability.

In the event we chose to or were required to terminate our relationship with a customer securitization vehicle, we would be obligated to hold any associated derivatives until their maturity. We would no longer receive fees for providing services relating to the securitizations, as previously described.

#### Structured Finance Vehicles

We facilitate development of investment products by third parties including mutual funds, unit investment trusts and other investment funds that are sold to retail investors. We enter into derivative contracts with these funds to provide the investors their desired exposure and hedge our exposure from these derivatives by investing in other funds. We also sponsor VIEs that provide investors access to debt portfolios through the issuance of commercial paper. We consolidate those VIEs where our interests expose us to a majority of the expected losses or residual returns, or both. Assets held by the VIEs in which we have a significant variable interest but we do not consolidate totalled $2,365 million as at October 31, 2007 ($762 million in 2006). Our exposure to loss from VIEs related to this activity is limited to the amount of our investment, which totalled $553 million as at October 31, 2007 ($216 million in 2006).

In the event we chose to terminate our relationship with these vehicles, we would be required to settle any associated derivatives at their fair value.

**Bank Securitization Vehicles**

Periodically, we sell loans to off-balance sheet entities or trusts, either for capital management purposes or to obtain alternate sources of funding. Gains on sales to the securitization vehicles, as well as revenues paid to us for servicing the loans sold, are recognized in income. The impact of securitization activities on our revenues and expenses is outlined in Note 7 on page 104 of the financial statements.

BMO has retained interests in these bank securitization vehicles, as we are sometimes required to purchase subordinated interests or maintain cash deposits in the entities and have recorded deferred purchase price amounts. These latter amounts represent gains on sales to securitization vehicles that have not been received in cash. Retained interests recorded as assets in our Consolidated Balance Sheet as at October 31, 2007 and 2006 were $388 million and $369 million, respectively. In the event there are defaults on the assets held by the vehicles, retained interests may not be recoverable and would then be written down. During the year ended October 31, 2007, there were $40 million of write-downs of retained interests in bank securitization vehicles ($36 million of write-downs in 2006). Further information on the impact of securitization activities on the Consolidated Balance Sheet is outlined in Note 7 on page 104 of the financial statements.

We provide further liquidity support to these securitization vehicles for the face value of the commercial paper outstanding. The total contract amount of the liquidity support provided to bank securitization vehicles was $5.1 billion at the end of 2007 ($5 billion in 2006). This amount comprised part of other credit instruments outlined in Note 5 on page 103 of the financial statements. No amounts were drawn upon at year-end.

During the year ended October 31, 2007, we changed the nature of the liquidity lines offered to bank securitization vehicles to global style liquidity lines, which have objective criteria for determining when they can be drawn upon.

Derivative contracts entered into with these vehicles enable the vehicles to manage their exposure to interest rate fluctuations.

The fair value of derivative contracts outstanding with these vehicles and recorded in our Consolidated Balance Sheet was a derivative liability of $52 million as at October 31, 2007 ($27 million in 2006). At October 31, 2007, we held $367 million of the commercial paper issued by these vehicles.

In the event we chose to terminate our relationship with a bank securitization vehicle, we would be required to settle any associated derivatives at their fair value. Any deferred purchase price recorded in our Consolidated Balance Sheet would continue to be collected from the securitization vehicle over time; however, no additional loans would be sold to that securitization vehicle.

**Credit Investment Management Vehicles**

Credit investment management vehicles provide investors with opportunities to invest in customized, diversified debt portfolios in a variety of asset and investment grade rating classes. We earned investment management fees of $21 million and $29 million in 2007 and 2006, respectively, for managing these portfolios.

We hold an interest in high grade Structured Investment Vehicles (SIVs). Our exposure to loss relates to our investments in these vehicles, derivatives contracts we have entered into with the vehicles and the liquidity support we provide through standby letters of credit and commitments to extend credit or purchase senior debt issued by the SIVs. Our investment in the capital notes of the SIVs was $53 million as at October 31, 2007 ($76 million in 2006) after a $15 million write-down in 2007 and was recorded as available-for-sale securities in our Consolidated Balance Sheet. We have also provided a funding commitment of $1.3 billion to purchase senior notes issued by the SIVs. As at October 31, 2007, $350 million was drawn and included in available-for-sale securities. The total contract amount of these letters of credit for backstop liquidity facilities was $221 million as at October 31, 2007 ($184 million in 2006). This amount comprised part of other credit instruments outlined in Note 5 on page 103 of the financial statements. No amounts were drawn at year-end.

The fair value of our derivative contracts outstanding with the SIVs as at October 31, 2007 was recorded in our Consolidated Balance Sheet as a derivative liability of $11 million ($18 million in 2006).

Subsequent to the year ended October 31, 2007, an additional $904 million was drawn against the funding commitment for the purchase of senior debt.

In the event we chose to terminate our relationship with these vehicles, any associated derivatives would be settled at their fair value and we would no longer receive administrative fees from the vehicle.

**Capital Trusts**

BMO Subordinated Notes Trust issued $800 million of BMO Trust Subordinated Notes (the "Notes"), the proceeds of which were used to purchase a senior deposit note from BMO. We hold all of the outstanding voting trust units in the Trust and will do so at all times while the Notes are outstanding. We have voting control of the Trust, but are not required to consolidate it. BMO will not terminate the Trust while the Notes are outstanding, unless the Trust has sufficient funds to pay the redemption price on the Notes and only with the approval of the Office of the Superintendent of Financial Institutions. We also provide a $30 million credit facility to this Trust, of which $5 million had been drawn at October 31, 2007. We guarantee payment of the principal, interest, redemption price, if any, and any other amounts on the Notes on a subordinated basis.

### Guarantees

Guarantees include contracts where we may be required to make payments to a counterparty based on changes in the value of an asset, liability or equity security that the counterparty holds. Contracts under which we may be required to make payments if a third party fails to perform according to the terms of a contract and contracts under which we provide indirect guarantees of indebtedness are also considered guarantees. In the normal course of business, we enter into a variety of guarantees, including standby letters of credit, backstop liquidity facilities and derivatives (including but not limited to credit default swaps and written options), along with indemnification agreements.

The maximum amount payable, without consideration of recovery through our recourse and collateral provisions, was $93 billion as at October 31, 2007.

For a more detailed discussion of these agreements, please see Note 6 on page 104 of the financial statements.

## Financial Instruments

As a financial institution, most of BMO's balance sheet is comprised of financial instruments and the majority of our net income results from gains, losses, income and expenses related to financial instruments.

Financial instrument assets include cash resources, securities, loans, customers' liabilities under acceptances and derivative instruments. Financial instrument liabilities include deposits, derivative instruments, acceptances, securities sold but not yet purchased, securities lent or sold under repurchase agreements, subordinated debt, preferred share liability and capital trust securities.

Financial instruments are used for both trading and non-trading activities. Non-trading activities generally include the business of lending, long-term investing, funding and asset-liability management.

Our use of financial instruments exposes us to credit and counterparty risk and various market risks, including equity price risk, commodity price risk, interest rate risk and foreign currency risk. A discussion of how we manage these and other risks as well as structural interest

rate sensitivities can be found in the Enterprise-Wide Risk Management section on pages 65 to 73 of this MD&A.

Further information on how we determine the fair value of financial instruments is included in the Financial Instruments Measured at Fair Value discussion in the Critical Accounting Estimates section of the MD&A that follows.

## Critical Accounting Estimates

The Notes to BMO's October 31, 2007 Consolidated Financial Statements outline our significant accounting estimates. The following accounting estimates are considered particularly important, as they require significant judgments by management. Management has established detailed policies and control procedures that are intended to ensure these judgments are well controlled, independently reviewed and consistently applied from period to period. We believe that our estimates of the value of BMO's assets and liabilities are appropriate.

### Allowance for Credit Losses

The allowance for credit losses adjusts the value of credit assets to reflect their estimated realizable value. In assessing their estimated realizable value, we must rely on estimates and exercise judgment regarding matters for which the ultimate outcome is unknown. These include economic factors, developments affecting companies in particular industries and specific issues with respect to single borrowers. Changes in circumstances may cause future assessments of credit risk to be materially different from current assessments, which could require an increase or decrease in the allowance for credit losses.

One of our key performance measures is the provision for credit losses as a percentage of average net loans and acceptances (including securities borrowed or purchased under resale agreements). Over the past 10 years, the ratio has ranged from a high of 0.66% in 2001 to a low of (0.07%) in 2004. This ratio varies with changes in the economy and credit conditions. If we applied these high and low ratios to average net loans and acceptances (including securities borrowed or purchased under resale agreements) in 2007, our provision for credit losses would range from a provision of $1,346 million to a net recovery of $143 million. Our provision for credit losses in 2007 was $353 million.

Additional information on the process and methodology for determining the allowance for credit losses can be found in the discussion of credit risk on page 67 as well as in Note 4 on page 101 of the financial statements.

### Financial Instruments Measured at Fair Value

BMO records securities and derivatives at their fair value. Fair value represents our estimate of the proceeds we would receive, or would have to pay in the case of a derivative liability, in a current transaction between willing parties.

We use a fair value hierarchy to categorize the inputs we use in valuation techniques to measure fair value. The extent of our use of quoted market prices (Level 1), internal models using observable market information as inputs (Level 2) and internal models without observable market information (Level 3) in the valuation of securities, derivative assets and derivative liabilities at October 31, 2007 was as follows:

| | Available-for-sale securities | Trading securities | Derivative instruments Asset | Derivative instruments Liability |
|---|---|---|---|---|
| Valued using quoted market prices | 59% | 93% | 8% | 8% |
| Valued using internal models (with observable inputs) | 35 | – | 91 | 91 |
| Valued using internal models (without observable inputs) | 6 | 7 | 1 | 1 |
| Total | 100% | 100% | 100% | 100% |

The fair values of most securities and exchange-traded derivatives are determined on a Level 1 basis, from quoted market prices. The majority of over-the-counter derivatives are valued using multi-contributor prices or models that utilize observable market data (Level 2). For example, the fair value of interest rate swaps is determined using yield curves developed from observable market interest rates. A small percentage of over-the-counter derivatives and securities are valued based upon inputs that are not observable or cannot be corroborated by market data (Level 3). For example, the fair value of a long-dated cross-currency swap may be determined using forward curve assumptions that can only be extrapolated from available market information. See page 68 for Market Risk discussion. Included in Level 3 for trading securities is the asset-backed commercial paper issued by non-bank-sponsored conduits and one BMO-sponsored conduit. Included in Level 3 for available-for-sale securities is our investment in the capital notes and senior notes of our BMO-sponsored SIVs. We determined the fair value of these securities using a variety of valuation techniques, including discounted cash flows, fair value of the underlying assets and proxy securities.

Valuation models use general assumptions and market data and therefore do not reflect the specific risks and other factors that would affect a particular instrument's fair value. As a result, we incorporate certain adjustments when using internal models to establish fair values. These fair value adjustments take into account the estimated impact of credit risk, liquidity risk, valuation considerations, administrative costs and closeout costs. For example, the credit risk adjustment incorporates credit risk into our determination of fair values by taking into account factors such as the counterparty's credit rating, the duration of the instrument and changes in credit spreads.

A group independent of the trading lines of business, Valuation Product Control (VPC), verifies the fair values at which financial instruments are recorded. For instruments that are valued using models, VPC identifies situations where adjustments must be made to the model estimates to arrive at fair value. During the year, we changed our valuation process to incorporate a more appropriate market-based valuation methodology for the commodities portfolio.

The methodologies used for calculating these adjustments are reviewed on an ongoing basis to ensure that they remain appropriate. Significant changes in methodologies are rare and are made only when we feel that the change will result in better estimates of fair value.

### Valuation Adjustments

| As at October 31 ($ millions) | **2007** | 2006 |
|---|---|---|
| Credit risk | **50** | 33 |
| Liquidity risk | **20** | 42 |
| Administrative costs | **7** | 7 |
| Other | **2** | 9 |
| | **79** | 91 |

The increase in the adjustment for credit risk was due to wider credit spreads and refinements to the calculation to reflect more market-based inputs. The reduction in the valuation adjustment for liquidity risk was primarily due to lower holdings of commodities derivatives.

### Accounting for Securitizations

When loans are securitized, we record a gain or loss on sale. In determining the gain or loss, management must estimate the net present value of expected future cash flows by relying on estimates of the amount of interest and fees that will be collected on the securitized assets, the yield to be paid to investors, the portion of the securitized assets that will be repaid before their scheduled maturity, credit losses, the fair value cost of servicing and the rate at which to discount these estimated future cash flows. Actual cash flows may differ significantly from those estimated by management. If management's estimate of future cash flows were different, our gain on securitization

recognized in income would also be different. The interest rate used to discount expected future cash flows is the estimate that most affects the gain on securitization. A 10% decrease in interest rates would have resulted in a decrease of less than $32 million in the amount of the deferred purchase price recorded in available-for-sale securities in our Consolidated Balance Sheet.

Additional information concerning accounting for securitizations, including sensitivity analysis for key assumptions, is included in Note 7 on page 104 of the financial statements.

### Accounting for Variable Interest Entities

In the normal course of business, BMO enters into arrangements with variable interest entities (VIEs). VIEs include entities with equity that is considered insufficient to finance the entity's activities or in which the equity holders do not have a controlling financial interest. We are required to consolidate VIEs if the investments we hold in these entities and/or the relationships we have with them result in us being exposed to the majority of their expected losses, being able to benefit from a majority of their expected residual returns, or both, based on a calculation determined by standard setters.

We use a qualitative estimation process to determine whether an entity is a VIE and whether BMO holds a variable interest in that VIE. We also use a variety of complex estimation processes involving qualitative and quantitative factors to calculate and analyze a VIE's expected losses and its expected residual returns. These processes involve estimating the future cash flows and performance of the VIE, analyzing the variability of those cash flows and allocating the losses and returns among the identified parties holding variable interests. These processes enable us to identify the party that is exposed to the majority of the VIE's expected losses, expected residual returns, or both, and thus which party should consolidate the entity.

Additional information concerning BMO's involvement with variable interest entities is included in Note 8 on page 106 of the financial statements.

### Pensions and Other Employee Future Benefits

BMO's pensions and other employee future benefits expense is calculated by our actuaries using assumptions determined by management. If actual experience differs from the assumptions used, pension and other employee future benefits expense could increase or decrease in future years. The expected rate of return on plan assets is the management estimate that most affects the calculation of pension expense. Our expected rate of return on plan assets is determined using the plan's target asset allocation and estimated rates of return for each asset class. Estimated rates of return are based on expected returns from fixed income securities, which take into consideration bond yields. An equity risk premium is then applied to estimate expected equity returns. Expected returns from other asset classes are established to reflect the risks of these asset classes relative to fixed income and equity assets. With all other assumptions held constant, a 1 percentage point decline in the expected rate of return on plan assets would result in an increase in pension expense for 2007 of approximately $41 million. The impact of changes in expected rates of return on plan assets is not significant for our other employee future benefits expense since only small amounts of assets are held in these plans.

Pension and other employee future benefits expense and obligations are also sensitive to changes in discount rates. For our Canadian plans, which currently represent 86% of BMO's pension obligations, we determine a discount rate at each year-end using market rates applicable to high-quality debt instruments with cash flows that match the timing and amount of expected benefit payments.

Additional information regarding our accounting for pensions and other employee future benefits, including sensitivity analysis for key assumptions, is included in Note 23 on page 125 of the financial statements.

### Other Than Temporary Impairment

We review available-for-sale and other securities at each quarter-end reporting period to identify and evaluate investments that show indications of possible impairment. An investment is considered impaired if its unrealized losses represent impairment that is considered to be other than temporary. In making this assessment, we consider such factors as the type of investment, the length of time and extent to which the fair value has been below the cost, the financial condition and near-term prospects of the issuer, and our intent and ability to hold the investment long enough to allow for any anticipated recovery. The decision to record a write-down, its amount and the period in which it is recorded could change if management's assessment of those factors were different. We do not record impairment write-downs on debt securities when impairment is due to changes in market interest rates, since we expect to realize the full value of these investments by holding them to maturity.

We also have investments in securities issued or guaranteed by Canadian or U.S. governments, corporate debt and equity securities, mortgage-backed securities and collateralized mortgage obligations. Quoted market value is considered to be fair value for actively traded securities. At the end of 2007, there were total unrealized losses of $48 million on securities on which the cost exceeded fair value and an impairment write-down had not been recorded. Of this amount, $14 million related to securities on which the cost had exceeded fair value for 12 months or more. In most cases, these unrealized losses resulted from increases in market interest rates and not from deterioration in the creditworthiness of the issuer.

Additional information regarding our accounting for available-for-sale securities and other securities is included in Note 3 on page 97 of the financial statements. Additional information concerning our method of determining fair value is included in Note 3 on page 98, Note 9 on page 110 and Note 29 on page 133 of the financial statements.

### Customer Loyalty Program

We record the liability related to our credit card customer loyalty program when our customers become entitled to redeem the rewards. We pay the loyalty program administrator when air miles are redeemed. In determining the liability, we estimate the expected future redemption rate and apply the cost of expected redemptions. Our estimate of the expected future redemption rate is based on a statistical analysis of past customer behaviour. Changes in actual redemption rates may cause future assessments of the liability to be different from the current assessment, resulting in an increase or decrease in the liability. Changes in redemption rates can result from factors such as shifts in customer behaviour, types of rewards offered and general economic conditions. If our estimate of the redemption rate increased by 1 percentage point, our annual card fee revenue would decrease by approximately $12 million. During fiscal 2007, we increased the liability related to future customer redemptions by $185 million ($120 million after-tax).

Additional information regarding our accounting for our customer loyalty program is included in Note 16 on page 117 of the financial statements.

### Income Taxes

The provision for income taxes is calculated based on the expected tax treatment of transactions recorded in our Consolidated Statements of Income or Changes in Shareholders' Equity. In determining the provision for income taxes, we interpret tax legislation in a variety of jurisdictions and make assumptions about the expected timing of the reversal of future tax assets and liabilities. If our interpretations differ from those of tax authorities or if the timing of reversals is not as anticipated, our provision for income taxes could increase or decrease in future periods. The amount of any such increase or decrease cannot be reasonably estimated.

Additional information regarding our accounting for income taxes is included in Note 24 on page 128 of the financial statements.

### Goodwill and Intangible Assets

Goodwill is assessed for impairment at least annually. This assessment includes a comparison of the carrying value and the fair value of each group of businesses to ensure that the fair value of the group is greater than its carrying value. If the carrying value exceeds the fair value of the group, a more detailed goodwill impairment assessment would have to be undertaken. In determining fair value, we use valuation models that use analysis of discounted cash flows, price-to-earnings ratios and other multiples. Management must exercise judgment and make assumptions in determining fair value, and different judgments and assumptions could affect the determination of fair value and any resulting impairment write-down. At October 31, 2007, the estimated fair value of each of our groups of businesses was significantly greater than its carrying value. In fact, the estimated fair value of any of our groups of businesses would have to decline by more than 30% before a detailed impairment assessment would be triggered.

Intangible assets are amortized to income on either a straight-line or an accelerated basis over a period not exceeding 15 years, depending upon the nature of the asset. There are no intangible assets with indefinite lives. We test intangible assets for impairment when circumstances indicate the carrying value may not be recoverable. No such impairment has been identified for the years ended October 31, 2007, 2006 and 2005.

Additional information regarding the composition of goodwill and intangible assets is included in Note 13 on page 115 of the financial statements.

### Contingent Liabilities

BMO and its subsidiaries are involved in various legal actions in the ordinary course of business.

Contingent litigation loss provisions are recorded when it becomes likely that BMO will incur a loss and the amount can be reasonably estimated. BMO's management and internal and external experts are involved in assessing any likelihood and in estimating any amounts involved. The actual costs of resolving these claims may be substantially higher or lower than the amounts provided. Additional information regarding contingent liabilities is included in Note 28 on page 132 of the financial statements.



## Changes in Accounting Policies in 2007

### Financial Instruments, Hedges and Comprehensive Income

On November 1, 2006, we adopted the CICA's new accounting requirements for securities, hedging derivatives and certain other financial instruments. Under these new rules, we are required to measure certain securities and hedging derivatives at fair value and include a new section in Shareholders' Equity, called Accumulated Other Comprehensive Income (Loss), to report unrealized gains or losses related to certain available-for-sale securities and cash flow hedges and foreign exchange gains or losses on our net investment in foreign operations.

Certain of our available-for-sale securities (previously referred to as investment securities) are recorded at fair value under the new rules. Unrealized gains or losses are deferred in Accumulated Other Comprehensive Income (Loss) until the securities are sold or there is impairment that is to be considered other than temporary. It is only at that time that any gain or loss is recorded in net income. Securities whose sale is restricted, or that are not traded in an active market, are also included in available-for-sale securities, but continue to be recorded at cost. The new rules do not affect accounting for our merchant banking investments or investments in corporate equity where we exercise significant influence, but not control.

All of our hedging derivatives are recorded at fair value under the new rules, but changes in fair value only impact net income to the extent that they do not perfectly offset changes in the fair value of the item that we are hedging (hedge ineffectiveness). Any hedge ineffectiveness is recorded in net income. Our hedging programs are such that hedging derivatives should very closely match the items that they hedge and, as a result, we do not expect a significant amount of hedge ineffectiveness to arise.

Unrealized gains and losses on equity securities included in Accumulated Other Comprehensive Income (Loss) are now included in our Tier 1 and Total Capital Ratios. The impact was insignificant at October 31, 2007. Foreign exchange gains or losses related to the translation of our net investment in foreign operations, which were also reported in Shareholders' Equity in prior periods, continue to be included in the determination of our capital ratios.

Total Accumulated Other Comprehensive Income (Loss) is included in Shareholders' Equity for purposes of calculating return on equity, which resulted in an insignificant increase in the return for 2007.

For details of the specific accounting changes and related impacts, refer to Notes 1, 3, 4, 9 and 15 to the financial statements.

## Future Changes in Accounting Policies

### Financial Instruments – Disclosure and Presentation

Effective for the fiscal year ending October 31, 2008, BMO will adopt the CICA's new handbook requirements regarding the disclosure and presentation of financial instruments. The new requirements are intended to enhance financial statement users' ability to evaluate the significance of financial instruments to an enterprise and the exposures inherent within these instruments, and to understand the entity's ongoing management of such exposures.

### Capital Disclosures

Consistent with enhancing disclosures on risk and management of risk, BMO will adopt the CICA's new handbook section establishing requirements to disclose both qualitative and quantitative information on capital management. This disclosure requirement is intended to enhance a reader's evaluation of an entity's objectives, policies and procedures related to ongoing capital management.

# Management's Annual Report on Disclosure Controls and Procedures and Internal Control over Financial Reporting

## Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the President & Chief Executive Officer (CEO) and the Executive Vice-President Finance and Treasurer and Acting Chief Financial Officer (Acting CFO), on a timely basis so that appropriate decisions can be made regarding public disclosure.

An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures was conducted as of October 31, 2007, by and under the supervision of BMO Financial Group's management, including the CEO and the Acting CFO. Based on this evaluation, the CEO and the Acting CFO have concluded that, as of October 31, 2007, our disclosure controls and procedures, as defined in Canada by Multilateral Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings, and in the United States by Rule 13a-15(e) under the *Securities Exchange Act of 1934* (the Exchange Act), are effective to ensure that information required to be disclosed in reports that we file or submit under Canadian securities legislation and the Exchange Act is recorded, processed, summarized and reported within the time periods specified therein.

## Internal Control over Financial Reporting

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian generally accepted accounting principles and the requirements of the Securities and Exchange Commission in the United States, as applicable. Management is responsible for establishing and maintaining adequate internal control over financial reporting for BMO Financial Group.

BMO's internal control over financial reporting includes policies and procedures that: pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of BMO; provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with Canadian generally accepted accounting principles and the requirements of the Securities and Exchange Commission in the United States, as applicable, and that receipts and expenditures of BMO are being made only in accordance with authorizations of management and directors of BMO; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of BMO's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Further, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

BMO Financial Group's management, including the CEO and the Acting CFO, has evaluated the effectiveness of our internal control over financial reporting using the framework and criteria established in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that internal control over financial reporting was effective as of October 31, 2007.

BMO Financial Group's auditors, KPMG LLP (Shareholders' Auditors), an independent registered public accounting firm, has issued an audit report on our internal control over financial reporting. This audit report appears on page 91.

## Changes in Internal Control over Financial Reporting

In connection with BMO Financial Group's review of its losses in its commodities trading business, BMO determined at the end of the second quarter of 2007 that a more appropriate market-based methodology should be used for valuing the commodities portfolio and that the independent price verification processes previously performed by BMO failed to identify price discrepancies. These factors, together with increased concerns with the reliability of quotes from BMO's principal broker used in the first quarter valuation, resulted in the restatement of BMO's previously reported financial statements for the quarter ended January 31, 2007.

In light of the foregoing, BMO made the following changes in the second, third and fourth quarters:

- placed two of our commodities professionals on leave. Those individuals are no longer employed by BMO;
- changed reporting lines within BMO Capital Markets for the commodities business, appointed a new head of energy trading and hired additional key personnel;
- suspended our business relationship with the principal broker used in the first quarter valuation;
- changed our independent price verification process to incorporate a more appropriate market-based valuation methodology for determining ongoing mark-to-market valuation of the commodities portfolio; and
- increased management oversight, implemented new risk limits and reduced existing risk limits.

Except for the above changes, there were no changes in our internal control over financial reporting in fiscal 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

# Pre-Approval of Shareholders' Auditors' Services and Fees

## Pre-approval Policies and Procedures

As part of BMO Financial Group's corporate governance practices, the Board ensures the strict application of BMO's corporate policy limiting the services provided by the Shareholders' Auditors that are not related to their role as auditors. All services provided by the Shareholders' Auditors are pre-approved by the Audit Committee as they arise, or through an annual pre-approval of amounts for specific types of services. All services comply with our Auditor Independence Policy, as well as professional standards and securities regulations governing auditor independence.

## Shareholders' Auditors' Fees

Aggregate fees paid to the Shareholders' Auditors during the fiscal years ended October 31, 2007 and 2006 were as follows:

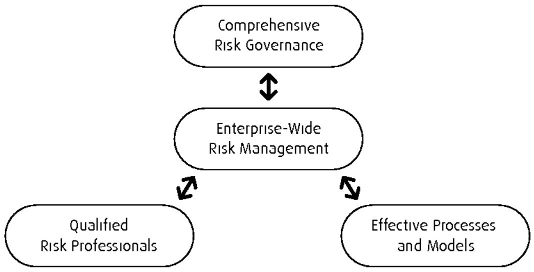
| Fees ($ millions) (1) | **2007** | 2006 |
|---|---|---|
| Audit fees | **12.0** | 10.7 |
| Audit-related fees (2) | **0.1** | 0.1 |
| Tax fees | **–** | – |
| All other fees (3) | **0.1** | 0.5 |
| Total | **12.2** | 11.3 |

(1) The classification of fees is based on applicable Canadian securities laws and United States Securities and Exchange Commission definitions.
(2) Audit-related fees for 2007 relate to fees paid for accounting advice and specified procedures on our Proxy Circular. Audit-related fees for 2006 relate to the same services provided in 2007 as well as fees paid for translation services.
(3) All other fees for 2007 and 2006 relate to fees paid for reviews of compliance with regulatory requirements for financial information and reports on internal controls over services provided by various BMO Financial Group businesses. Also included in 2006 are corporate recovery services that were grandfathered when BMO's Auditor Independence Policy came into effect.

# Enterprise-Wide Risk Management



BMO Financial Group has an enterprise-wide approach to the identification, measurement, monitoring and management of risks faced across the organization. These risks are classified as credit and counterparty, market, liquidity and funding, operational, business, reputation and environmental risk.




BMO's risk management framework guides our risk-taking activities and ensures that they are aligned with client needs, shareholder expectations and regulatory requirements. The framework provides for not only the direct management of each individual risk type but also the management of risks on an integrated basis. It consists of comprehensive risk governance, effective processes and models, and qualified risk professionals.

### Comprehensive Risk Governance

BMO's risk governance structure promotes making sound business decisions by balancing risk and reward. It promotes revenue-generating activities consistent with our standards and risk tolerance levels and drives the maximization of long-term shareholder return.

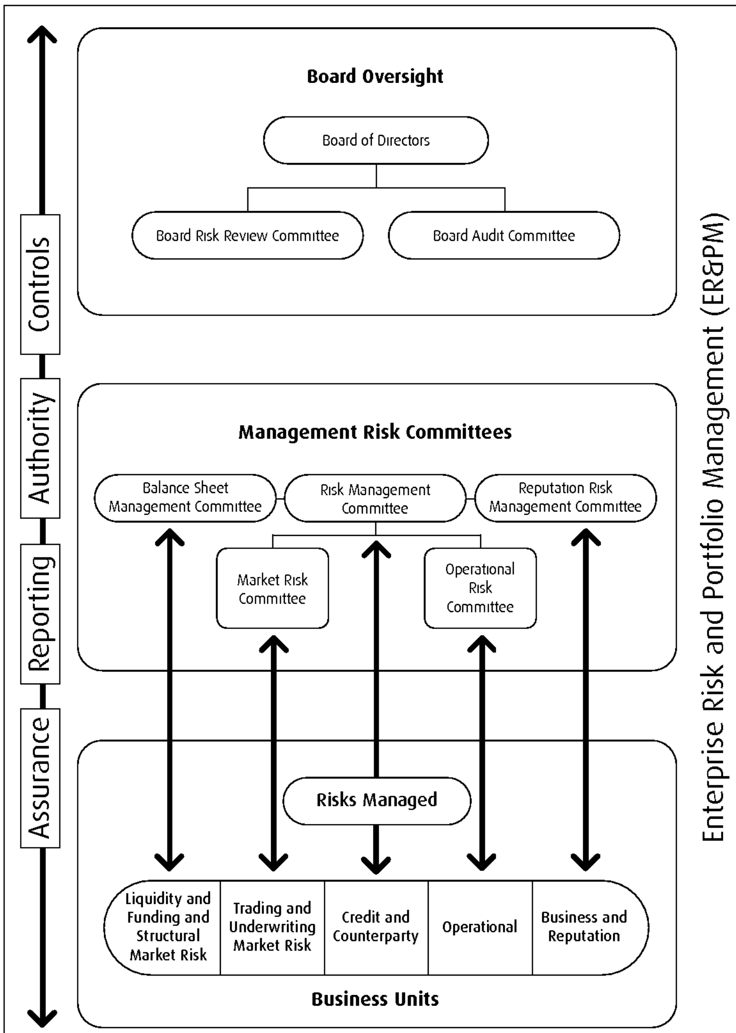
Our comprehensive risk governance structure (see box below) includes a body of corporate policies approved by the Board of Directors or its committees, as well as supporting corporate standards and operating procedures. These are reviewed on a regular basis to ensure that they provide effective guidance for the governance of our risk-taking activities. In each line of business, management ensures that governance activities, controls and management processes and procedures are consistent with our overall risk management framework.

Risk limits, which define BMO's risk tolerance, are reviewed and approved annually by the Risk Review Committee of the Board for:

- credit and counterparty risk – limits on country, industry, portfolio/product segments, group and single-name exposures;
- market risk – limits on Market Value Exposure (MVE), Earnings Volatility (EV) and stress testing exposures; and
- liquidity and funding risk – limits on minimum levels of liquid assets and asset pledging, and guidelines approved by senior management for liability diversification and credit and liquidity commitments.

These risk limits generally encompass both on- and off-balance sheet arrangements.

Individual governance committees further establish and monitor comprehensive risk management limits consistent with and subordinate to the Board-approved limits. Loss limits are also in place, providing an early warning mechanism to effectively address potential loss situations.




**Risk Review Committee of the Board of Directors (RRC)** assists the Board in fulfilling its oversight responsibilities in relation to BMO's identification and management of risk, adherence to internal risk management policies and procedures, and compliance with risk-related regulatory requirements.

**Audit Committee of the Board of Directors** independently monitors and reports to the Board of Directors on the effectiveness of disclosure controls and procedures and internal controls, including internal control over financial reporting.

**The President and Chief Executive Officer (CEO)** is directly accountable to the Board for all of BMO's risk-taking activities. Risk Management Committee and its sub-committees as well as Enterprise Risk and Portfolio Management support the CEO.

**Risk Management Committee (RMC)**, BMO's senior risk committee, reviews and discusses significant risk issues and action plans that arise in executing the enterprise-wide strategy. RMC ensures that risk oversight and governance occur at the highest levels of management.

**RMC Sub-committees** have oversight responsibility for management strategy, governance, risk measurement and contingency planning. RMC and its sub-committees ensure that the risks incurred across the enterprise are consistent with strategy and are identified, measured, monitored and reported in accordance with policy and within delegated limits.

**Enterprise Risk and Portfolio Management (ER&PM)** encompasses credit adjudication and oversight as well as the management and oversight of the operational and market risk functions. It ensures consistency of risk management practices and standards across the enterprise. ER&PM facilitates a disciplined approach to risk-taking through the execution of transactional and portfolio management, policy formulation, risk reporting, modelling, vetting and risk education responsibilities. This ensures corporate objectives are met while risks taken are consistent with BMO's risk tolerance.

**Business Units** own and are responsible for managing risk within their respective business unit. They do this by ensuring that policies, processes and internal controls are in place and by escalating significant risk issues.

During the year, we recorded losses in our commodities trading business, and we have now taken a number of steps to significantly reduce the size of the portfolio and its risk. We have reduced certain limits and increased the number of risk measures with limits for our commodities book. Step-down and target limits were established for identified measures, and we are on track with several of the measures already within target limits. We expect to achieve the remaining desired risk reduction in the book through the ongoing trading activity of the business, as we continue to reduce the aggregate size of the book. During 2007 we conducted a review of valuation practices across our trading books. Further information on commodity-related matters can be found in the Market Risk discussion beginning on page 68.

## Effective Processes and Models

Rigorous processes, periodically reviewed by Corporate Audit Division, are used across BMO to:

- develop policies and limits for approval by senior management and the appropriate governance committees;
- monitor compliance with policies and limits;
- maintain contingency plans;
- track variables for changing risk conditions; and
- provide timely reports to senior management and the appropriate governance committees.

Models used range from the very simple to those that value complex transactions or involve sophisticated portfolio and capital management methodologies. These models are used to guide strategic decisions and to assist in making daily lending, trading, underwriting, funding, investment and operational decisions. Models have also been developed to measure exposure to specific risks and to measure total risk on an integrated basis, using Economic Capital. We have strong controls over the development, implementation and application of these models, which are subject to a periodic independent model risk vetting process.

BMO also utilizes various processes and models within risk types to:

- assess the correlation of credit risks before authorizing new exposures;
- measure and value portfolio exposures and calculate related market risk exposure;
- measure the operational and business risk for each line of business; and
- estimate liquidity and funding risk based on expected and stressed operating conditions.

## Qualified Risk Professionals

Sound enterprise-wide risk management relies upon the competence and experience of our risk professionals to:

- promote a culture that places high value on disciplined and effective risk management processes and controls;
- ensure adherence to established risk management standards for the evaluation and acceptance of risk; and
- apply sound business judgment, using effective business models in decision-making.

To enhance existing risk management capabilities, managers and lenders are offered a progressive curriculum of credit risk courses by BMO's Institute for Learning. These courses, together with defined job exposures, provide training and practice in sound credit risk management as a prerequisite to the granting of appropriate discretionary lending limits to qualified professionals.

## Integrated Risk Management

Integrated Risk Management encourages a strong risk management culture and ensures alignment with BMO's enterprise-wide strategic goals.

The management of risk is integrated with our strategy and our management of capital. This ensures that risks incurred in pursuit of BMO's strategic objectives are consistent with our targets for total shareholder return and credit ratings, as well as our risk tolerance.

BMO's risk management is supported by the Initiative Decisioning Process model, which ensures that changes to the enterprise's risk

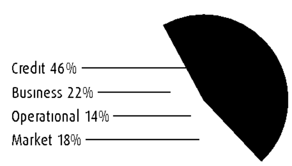
| Target for total shareholder return | Target for credit ratings, given target business mix |
|---|---|
| ↓ | ↓ |

**BMO's Risk Tolerance**
**Approved by the Board of Directors for each major category of risk and delegated to management in the lines of business through the CEO**

profile associated with new business initiatives are correctly identified and receive appropriate approvals prior to acceptance or implementation. Risk management is also supported by processes that use enterprise-wide Economic Capital measures, stress testing and scenario analysis to assess the relative magnitude of risks taken and the distribution of those risks across the enterprise's activities.

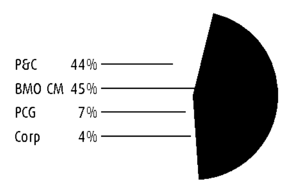
Economic Capital provides a single measure of risk that can be compared across business activities and risk types. It is the foundation for risk-based capital management and permits the cost of capital to be charged to the lines of business. Economic Capital indicates, in terms of capital, the likely magnitude of economic losses that could occur if adverse situations arise and allows returns to be adjusted for risks. Economic Capital is calculated for various types of risk – Credit, Market (trading and non-trading), Operational and Business – where measures are based on a time horizon of one year.

**Total Economic Capital by Risk Type**
As at October 31, 2007




Credit Risk remains the largest component of Economic Capital by risk type.

**Total Economic Capital by Operating Group**
As at October 31, 2007




BMO Capital Markets carried the largest share of Economic Capital in 2007.

Stress testing and scenario analysis assist in measuring the impact on our operations of extreme but plausible operational, political, economic and market events. Scenarios designed in collaboration with our economists, equity research department and business units are based on historical or hypothetical events, a combination thereof, or significant economic developments such as a rapid increase in the value of the Canadian dollar, a real estate downturn or higher energy costs. These tests and analyses are then applied to all significant and relevant risk-taking portfolios across the enterprise. As stipulated by the Basel II Capital Accord, BMO also conducts stress testing of Regulatory Credit Capital across all material portfolios using the Advanced Internal Ratings Based (AIRB) Approach calculation methodology.

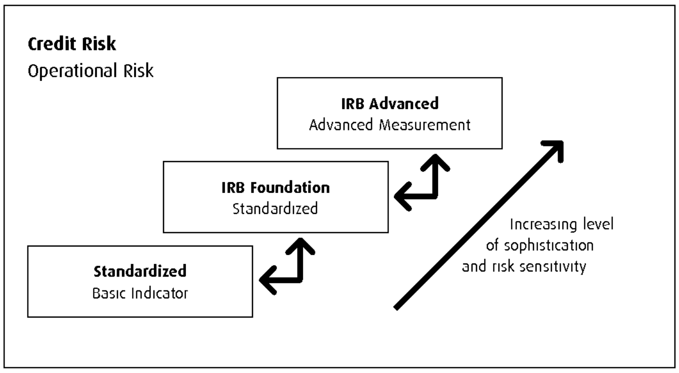
We also conduct ongoing cross-business and wholesale (Corporate and Commercial) stress testing and scenario analysis designed to test BMO's credit exposures to a specific industry or to several industries that are highly correlated. These tests attempt to gauge the effect of various scenarios on default probabilities and loss rates in the portfolio under review. This provides senior management with significant insight into the sensitivity of our exposures to underlying risk characteristics of specific industries.

## Basel II (International Convergence of Capital Measurement and Capital Standards: A Revised Framework)

**Framework**

The final Basel II Framework was issued by the Basel Committee on Banking Supervision (BCBS) in June 2006. The Framework was developed

to strengthen the soundness and stability of the international banking system, promote the adoption of stronger risk management practices and develop more risk-sensitive capital requirements. The Framework allows banking enterprises to choose from three increasingly risk-sensitive approaches to the calculation of credit and operational risk regulatory capital requirements, as outlined in the graphic below, and promotes the use of an enterprise's own internal estimates.




The Basel II Framework introduced the concept of "three pillars" for the reporting and monitoring of risk-based regulatory capital. BMO continues to work towards meeting all of the applicable requirements of the Basel II Framework.

### The First Pillar

The first pillar outlines new methodologies to be used in the determination of the minimum capital requirements for credit risk and operational risk.

### The Second Pillar

One of the fundamental principles of the second pillar is that banks should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels. This process includes addressing all material risks, including risks not captured within the first pillar. Another important principle of the second pillar is that regulators are to evaluate banks' internal capital adequacy assessments. Banks are expected to maintain capital ratios that exceed the minimum regulatory ratios. Building on the work that we are doing to implement the first pillar, we are reviewing our process for assessing overall capital adequacy in relation to our risk profile.

### The Third Pillar

The third pillar delineates the market disclosures required from banks, in order that the market may have better information in regards to the overall risk position of a bank. BMO will be implementing disclosure that complies with the Basel II Framework throughout fiscal 2008.

BMO views Basel II as an important step in the alignment of regulatory and economic capital requirements. We have an integrated enterprise-wide program for managing the implementation of Basel II. Leadership and oversight for Basel II activities are provided by an Executive Steering Committee.

BMO has filed an application with our regulator, OSFI, to apply the most advanced approach (AIRB) for Credit Risk on our portfolio, except for our subsidiary Harris Bankcorp, Inc., where we have requested a waiver to apply the Standardized Approach. The approval decision from the regulator is pending. We have adopted the Standardized Approach for Operational Risk.



## Credit and Counterparty Risk

**Credit and counterparty risk** is the potential for loss due to the failure of a borrower, endorser, guarantor or counterparty to repay a loan or honour another predetermined financial obligation. This is the most significant measurable risk that BMO faces.

BMO incurs credit and counterparty risk primarily in its lending activities, including the sale of treasury and other capital markets products and, to a lesser extent, in its holding of investment securities. Effective credit risk management begins with BMO's experienced and skilled professional lending and credit risk officers, who together operate in a dual control structure to authorize transactions that expose the enterprise to credit risk. These individuals are subject to a rigorous lender qualification process, and operate in a disciplined environment with clear delegation of decision-making authority, including individually delegated lending limits. Credit decision-making is conducted at the management level appropriate to the size and risk of each transaction in accordance with comprehensive corporate policies, standards and procedures governing the conduct of credit risk activities.

Operating practices include the ongoing monitoring of credit risk exposures and regular portfolio and sector reporting to the Board and senior management committees. Performing accounts are reviewed on a regular basis, with most commercial and corporate accounts reviewed at least annually. The frequency of reviews is increased in accordance with the likelihood and size of potential credit losses, with deteriorating higher-risk situations referred to specialized account management groups for closer attention where appropriate. Corporate Audit Division reviews and tests management processes and controls and samples credit transactions for adherence to credit terms and conditions, and to governing policies, standards and procedures. In addition, BMO carries out regular portfolio sector reviews, including stress testing and scenario analysis based on current, emerging or prospective risks.

For the consumer and small business portfolios, credit risk models and decision systems are developed using established statistical techniques and expert systems for underwriting and monitoring purposes. Adjudication models, behavioural scorecards, decision trees and expert knowledge are combined to produce optimal credit decisions in an automated environment. The characteristics of both the borrower and the loan, along with past portfolio experience, are used to predict the credit performance of new accounts. Past performance is also used, as appropriate, to predict the likely future behaviour of existing accounts for ongoing credit risk management.

For the commercial and corporate portfolios, BMO utilizes an enterprise-wide risk rating framework that applies to all its sovereign, bank, corporate and commercial counterparties. This framework is consistent with the principles of Basel II, under which future minimum regulatory capital requirements for credit risk will be determined. One key element of this framework is the assignment of appropriate borrower risk ratings to help quantify potential credit risk.

Under BMO's risk rating framework, a counterparty's risk rating is assessed using methodologies and rating criteria tailored to the specific risk characteristics of the counterparty, and the resulting rating is then mapped to a predetermined default probability over a one-year time horizon. As counterparties migrate between risk ratings, their probability of default changes. Losses are estimated based on the expected proportion of the exposure that will be at risk if a counterparty default occurs, through an analysis of transaction-specific factors such as the nature and terms of the loan, collateral held and the seniority of our claim. For large corporate transactions, we also utilize unexpected loss models to assess the extent and correlation of risks before authorizing new exposures.

We employ a disciplined approach to provisioning and loan loss evaluation, with prompt identification of problem loans being a key risk

management objective. BMO maintains both specific and general allowances for credit losses, the sum of which must always be sufficient to reduce the book value of credit assets to their estimated realizable value. Specific allowances reduce the aggregate carrying value of credit assets where there is evidence of deterioration in credit quality.

We maintain a general allowance in order to cover any impairment in the existing portfolio that cannot yet be associated with specific loans. Our approach to establishing and maintaining the general allowance is based on the guideline issued by our regulator, OSFI. The general allowance is reviewed on a quarterly basis and a number of factors are considered when determining the appropriate level of the general allowance. This includes a general allowance model that applies historical expected and unexpected loss rates, based on probabilities of default and loss given default factors, to current balances. For business loans, these historical loss rates are associated with the underlying risk rating of the borrower which is assigned at the time of loan origination, monitored on an ongoing basis, and adjusted to reflect changes in underlying credit risk. These loss rates are further refined with regard to industry sectors and credit products. For consumer loans, these loss rates are based on historical loss experience for the different portfolios. Model results are then considered along with the level of the existing allowance and management's judgment regarding portfolio quality, business mix, and economic and credit market conditions.

We use credit derivative products to enhance the management of our portfolio of credit risk assets, in particular our corporate loan book. In 2007, we were active in the use of single-name credit default swaps to mitigate the credit risk related to specific client credit exposures.

BMO's credit risk governance policies ensure that an acceptable level of diversification is maintained at all times. The use of industry structural risk factor limits ensures diversification of risk in the commercial and corporate lending portfolios, and allows us to closely monitor sectors of concern as required. At year-end, our credit assets consisted of a well-diversified portfolio comprised of millions of clients, the majority of them consumers and small to medium-sized businesses.

Our credit risk management processes are both well-established and effective: In 14 of the past 15 years, BMO's specific credit losses as a percentage of loans and acceptances, including securities borrowed or purchased under resale agreements, were lower than the average of our Canadian peer group. Over this 15-year period, BMO's average loss rate was 28 basis points, compared with an average of 47 basis points for our largest peers. These favourable results were achieved in consumer loans, as well as corporate and commercial loans.

Provisions for credit losses are discussed on page 39. Note 4 on page 101 of the financial statements and Tables 11 to 19 on pages 84 to 87 provide details of BMO's loan portfolio, impaired loans and provisions and allowances for credit losses.

## Market Risk

BMO incurs market risk in its trading and underwriting activities and structural banking activities.

As part of our enterprise-wide risk management framework, we employ comprehensive governance and management processes surrounding market risk-taking activities. These include:

- oversight by senior governance committees, including Market Risk Committee (MRC), Balance Sheet Management Committee (BSMC), RMC and RRC;
- independent market risk oversight functions;
- processes for the valuation of trading positions and the measurement of market risks, which are linked to the allocation of Economic Capital;
- a well-developed limit-setting and monitoring process;
- effective controls over processes and models used; and
- a framework of scenario and stress tests for worst-case events.

BMO's primary market risk measures are Market Value Exposure (MVE) and Earnings Volatility (EV). The aggregate market value and earnings volatility exposures at October 31, 2007 are summarized in the following table. Total MVE has decreased over the past year largely as a result of lower modelled structural interest rate volatility. Interest rate volatility is derived from 10 years of historical data that in fiscal 2007 excludes the high volatility associated with fiscal 1997. Total EV has decreased relative to last year, mainly due to reduced exposure in the commodity portfolios coupled with reduced interest rate exposure in the mark-to-market and accrual accounted money market portfolios.

### Aggregate MVE and EV for Trading and Underwriting and Structural Positions ($ millions)*

| As at October 31, 2007 (After-tax Canadian equivalent) | Market value exposure | | 12-month earnings volatility | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| Trading and Underwriting | **(18.2)** | (23.4) | **(12.6)** | (17.5) |
| Structural | **(249.9)** | (267.0) | **(24.2)** | (24.1) |
| Total | **(268.1)** | (290.4) | **(36.8)** | (41.6) |

*Measured at a 99% confidence interval.

**Market risk** is the potential for a negative impact on the balance sheet and/or income statement resulting from adverse changes in the value of financial instruments as a result of changes in certain market variables. These variables include interest rates, foreign exchange rates, equity and commodity prices and their implied volatilities, as well as credit spreads, credit migration and default.

**Market Value Exposure (MVE)** is a measure of the adverse impact of changes in market parameters on the market value of a portfolio of assets, liabilities and off-balance sheet positions, measured at a 99% confidence level over a specified holding period. The holding period considers current market conditions and composition of the portfolios to determine how long it would take to neutralize the market risk without adversely affecting market prices. For trading and underwriting activities, MVE is comprised of Value at Risk and Issuer Risk.

**Earnings Volatility (EV)** is a measure of the adverse impact of potential changes in market parameters on the projected 12-month after-tax net income of a portfolio of assets, liabilities and off-balance sheet positions, measured at a 99% confidence level over a specified holding period.

**Value at Risk (VaR)** is measured for specific classes of risk in BMO's trading and underwriting activities: interest rate, foreign exchange rate, equity and commodity prices and their implied volatilities. This measure calculates the maximum likely loss from portfolios, over a specified holding period, measured at a 99% confidence level.

**Issuer Risk** arises in BMO's trading and underwriting portfolios, and measures the adverse impact of credit spread, credit migration and default risks on the market value of fixed income instruments and similar securities. Issuer risk is measured at a 99% confidence level over a specified holding period.

## Trading and Underwriting Market Risk

BMO's Market Risk group provides oversight of trading and underwriting portfolios by ensuring:

- market risk of trading and underwriting portfolios is measured and modelled in compliance with corporate policies and standards;
- risk profiles of our trading and underwriting portfolios are maintained within our risk appetite, and are monitored and reported to traders, senior executives, management and board committees;
- proactive identification and reporting to senior executives, management and board committees of specific exposures or other factors that expose BMO to unusual, unexpected, inappropriate or otherwise not fully identified or quantified risks associated with market or traded credit exposures;
- all individuals authorized to execute trading and underwriting transactions on behalf of BMO are appropriately informed of BMO's risk-taking governance, authority structure, procedures and processes by providing access to and guidance on the relevant corporate policies and standards.

Within Market Risk, the Valuation Product Control group checks whether the valuation of all trading and underwriting portfolios within BMO is materially accurate by:

- developing and maintaining valuation adjustment/reserve policies and procedures in accordance with regulatory requirements and GAAP;
- establishing official rate sources for valuation of mark-to-market portfolios;
- providing an independent review of trading books where trader prices are used for valuation of mark-to-market portfolios.

At minimum, the following major categories of valuation reserves are considered when determining appropriate valuation adjustment/reserve levels: unearned credit spreads, close-out costs, administrative costs, liquidity and model risk. Senior management and executives are advised of, and acknowledge all valuation adjustments/reserves on a monthly basis.

Our models are used to determine market risk economic capital for each of the lines of business and to determine regulatory capital. For capital calculation purposes, longer holding periods and/or higher confidence levels are used than are employed for day-to-day risk management. Models used to determine EV exposures are the same as or similar to those used to determine VaR exposures. Prior to use, models are subject to review under the Model Risk Corporate Standard by our Model Risk & Vetting group. The Model Risk Corporate Standard articulates minimum acceptable requirements for the identification, assessment, monitoring and management of models and model risk throughout the enterprise.

During 2007, we incurred unacceptably high commodities losses. We have made improvements to our independent price verification process with the inclusion of multi-contributor prices for the valuation of the commodities portfolio. Risk controls have been augmented and the level of risk within the portfolio has been reduced. A review of valuation practices across trading books was conducted during the third quarter.

BMO measures the risk of trading and underwriting portfolios that meet our criteria for trading book regulatory capital treatment using an internal models approach, as well as the risk of money market portfolios that are subject to accrual accounting rules under GAAP and are accorded banking book regulatory capital treatment.

For trading and underwriting portfolios covered by the internal models approach, VaR is computed using BMO's Comprehensive Value at Risk model. Our Comprehensive Value at Risk model is a Monte Carlo scenario simulation model, and its output is used for market risk management and reporting of exposures. The model computes 1-day VaR results using a 99% confidence interval and reflects the correlations between the different classes of market risk factors. For money market accrual portfolios, VaR is computed using an Analytic Value at Risk approach.

In the fourth quarter, BMO recorded valuation adjustments related to the deterioration in capital markets. Details of these valuation adjustments and other charges can be found in the Trading-Related Revenue section on page 38 and the BMO Capital Markets section on page 53.

Market risk exposures arising from trading and underwriting activities are summarized in the following table. Trading and underwriting Market Value Exposure has decreased year over year, mainly due to reduced exposure in the commodity portfolios coupled with reduced interest rate exposure in the mark-to-market and accrual accounted money market portfolios.

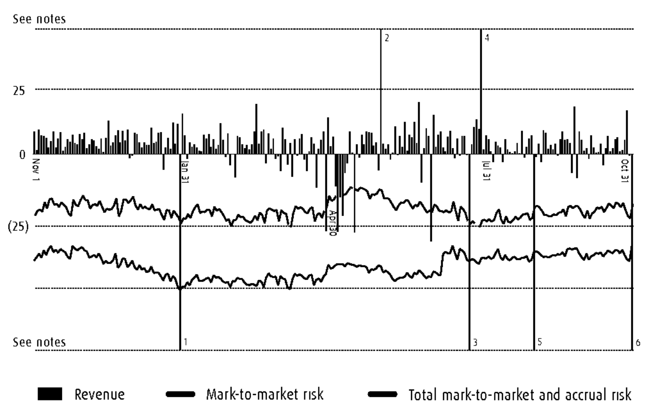
### Total Trading and Underwriting MVE Summary ($ millions)*

| For the year ended October 31, 2007 (pre-tax Canadian equivalent) | Year-end | Average | High | Low |
|---|---|---|---|---|
| Commodity risk | **(2.7)** | **(6.4)** | **(16.8)** | **(2.7)** |
| Equity risk | **(9.5)** | **(10.2)** | **(17.7)** | **(5.1)** |
| Foreign exchange risk | **(0.9)** | **(1.2)** | **(5.6)** | **(0.2)** |
| Interest rate risk (mark-to-market) | **(4.7)** | **(5.8)** | **(14.3)** | **(2.3)** |
| Diversification | **3.8** | **7.7** | **12.6** | **2.8** |
| Comprehensive risk | **(14.0)** | **(15.9)** | **(25.7)** | **(8.0)** |
| Interest rate risk (accrual) | **(9.1)** | **(17.4)** | **(26.8)** | **(8.6)** |
| Issuer risk | **(4.9)** | **(5.2)** | **(9.0)** | **(3.2)** |
| Total MVE | **(28.0)** | **(38.5)** | **(51.2)** | **(27.9)** |

| For the year ended October 31, 2006 (pre-tax Canadian equivalent) | Year-end | Average | High | Low |
|---|---|---|---|---|
| Commodity risk | (8.4) | (5.9) | (13.8) | (1.5) |
| Equity risk | (9.8) | (4.6) | (10.5) | (2.6) |
| Foreign exchange risk | (3.3) | (1.4) | (5.1) | (0.1) |
| Interest rate risk (mark-to-market) | (7.1) | (4.0) | (9.8) | (1.9) |
| Diversification | 10.4 | 6.7 | 12.4 | 3.7 |
| Comprehensive risk | (18.2) | (9.2) | (19.1) | (4.2) |
| Interest rate risk (accrual) | (12.0) | (10.8) | (34.7) | (5.6) |
| Issuer risk | (5.8) | (4.7) | (8.3) | (2.8) |
| Total MVE | (36.0) | (24.7) | (53.3) | (16.2) |

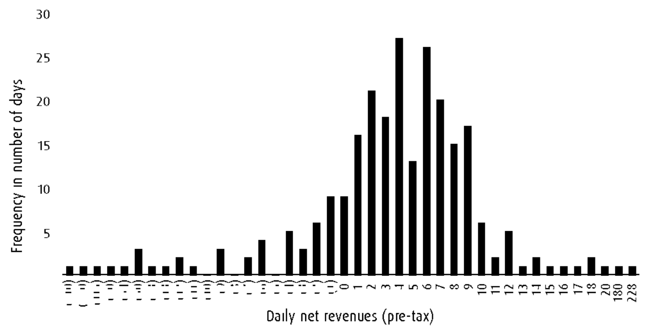
*One-day measure using a 99% confidence interval.

**Trading and Underwriting Net Revenues versus Market Value Exposure**
November 1, 2006 to October 31, 2007 ($ millions)




(1) January 31, 2007: Primarily reflects the restatement of $(509) million made to first quarter results to reflect the impact of a more appropriate market-based valuation methodology applied to our commodities portfolio. Daily Net Revenue ($506) million.
(2) May 31, 2007: Primarily reflects the impact of a more appropriate market-based valuation methodology applied to our commodities portfolio. Daily Net Revenue $182 million.
(3) July 24, 2007: Primarily reflects losses taken to neutralize a large proprietary position in the commodities book. The loss reported excludes valuation adjustments related to these positions. Daily Net Revenue ($250) million.
(4) July 31, 2007: Primarily reflects the recognition of the reversal of valuation adjustments related to the commodity positions that were neutralized on July 24, 2007. Daily Net Revenue $229 million.
(5) August 31, 2007: Primarily reflects valuation adjustments on trading and structured credit related positions. Daily Net Revenue ($80) million.
(6) October 31, 2007: Primarily reflects valuation adjustments of approximately $(135) million on Canadian asset-backed commercial paper. Daily Net Revenue ($117) million.

**Frequency Distribution of Daily Net Revenues**
November 1, 2006 to October 31, 2007 ($ millions)




The distribution of our daily net revenue for the portfolios has been impacted by restatements to our commodities business and periodic valuation adjustments as outlined in the notes to the preceding Trading and Underwriting Net Revenues versus Market Value Exposure graph.

Trading revenues include amounts from all trading and underwriting activities, whether accounted for on a mark-to-market basis or an accrual basis, as well as certain fees and commissions directly related to those activities.

We use a variety of methods to ensure the integrity of our risk models, including the application of backtesting against hypothetical losses. This process assumes there are no changes in the previous day's closing positions. The process then isolates the effects of each day's price movements against these closing positions. Models are validated by assessing how often the calculated hypothetical losses exceed the MVE measure over a defined period. Results of this testing confirm the reliability of our models.

The models used to measure market risks are effective at measuring risks under normal market conditions. In addition, we perform scenario analysis and probabilistic stress testing on a daily basis to determine the impact of unusual and/or unexpected market changes on our portfolios. As well, historical and event stresses are tested on a weekly basis. Scenarios are amended, added or deleted, to better reflect changes in underlying market conditions. The results are reported to the line of business, MRC, RMC and RRC on a regular basis.

## Structural Market Risk

Structural market risk is comprised of interest rate risk arising from our banking activities (loans and deposits) and foreign exchange risk arising from our foreign currency operations. Structural market risk is managed by BMO's Corporate Treasury in support of stable, high-quality earnings, and maximization of sustainable product spreads.

Structural interest rate risk arises primarily from interest rate mismatches and embedded options. Interest rate mismatches result from differences in the scheduled maturity or repricing dates of assets, liabilities and off-balance sheet items. Embedded option risk results from product features that allow customers to modify scheduled maturity or repricing dates. Embedded options include loan prepayment and deposit redemption privileges and committed rates on unadvanced mortgages. The net interest rate mismatch, representing residual assets funded by common shareholders' equity, is managed to a target duration, which is currently between two and three years, while embedded options are managed to low risk levels. The interest rate mismatch is primarily managed with interest rate swaps and securities. Embedded option exposures are managed by purchasing options or through a dynamic hedging process.

Structural foreign exchange risk arises primarily from translation risk associated with the net investment in our U.S. operations, and from transaction risk associated with our U.S.-dollar-denominated net income. Translation risk is managed by funding our net U.S. investment in U.S. dollars. Transaction risk is managed by entering into foreign exchange forward contract hedges each quarter that are expected to partially offset the effects of Canadian/U.S. dollar exchange rate fluctuations on the quarter's net income. The impact of exchange rate fluctuations on BMO's 2007 net income is reviewed on page 35.

Structural MVE and EV measures both reflect holding periods of between one and three months and incorporate the impact of correlation between market variables. Structural MVE (see page 68) has decreased in fiscal 2007 as a result of lower modelled interest rate volatility. Interest rate volatility is derived from 10 years of historical data that in fiscal 2007 excludes the high volatility associated with fiscal 1997. EV continues to be managed to low levels.

In addition to MVE and EV, we use simulations, sensitivity analysis, stress testing and gap analysis to measure and manage interest rate risk. Gap analysis is disclosed in Note 20 on page 119 of the financial statements.

Structural interest rate sensitivity to an immediate parallel increase or decrease of 100 and 200 basis points in the yield curve is disclosed in the table below. This sensitivity analysis is performed and disclosed by many financial institutions and facilitates comparison with our peer group.

### Structural Interest Rate Sensitivity ($ millions)*

| After-tax Canadian equivalent | **As at October 31, 2007** | | As at October 31, 2006 | |
|---|---|---|---|---|
| | **Economic value sensitivity** | **12 month earnings sensitivity** | Economic value sensitivity | 12-month earnings sensitivity |
| 100 basis point increase | **(241.1)** | **6.6** | (237.4) | 10.9 |
| 100 basis point decrease | **180.1** | **(15.4)** | 181.6 | (10.5) |
| 200 basis point increase | **(516.6)** | **0.4** | (508.0) | 12.1 |
| 200 basis point decrease | **318.6** | **(17.0)** | 318.3 | (4.1) |

*Exposures are in brackets and benefits are represented by positive amounts.

Models used to measure structural market risk project how interest rates and foreign exchange rates may change and predict how customers would likely react to the changes. For customer loans and deposits with scheduled maturity and repricing dates (e.g. mortgages and term deposits), our models measure how customers use embedded options to modify those terms. For customer loans and deposits without scheduled maturity and repricing dates (e.g. credit card loans and chequing accounts), our models impute a maturity profile that considers pricing and volume strategies and is reflective of the associated uncertainties. These models have been developed using statistical analysis and are validated through regular model vetting and backtesting processes and ongoing dialogue with the lines of business. Models used to predict consumer behaviour are also used in support of product pricing and performance measurement.